

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
BRIEF**

74-1810

United States Court of Appeals

For the Second Circuit.

B
P/S

ESTATE OF LORRAINE A. MCGAULEY, Deceased,
FREDERICK F. MCGAULEY, Temporary Executor,
Petitioner-Appellant,

VERSUS

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

ON APPEAL FROM THE UNITED STATES TAX COURT.

PETITIONER-APPELLANT'S BRIEF.

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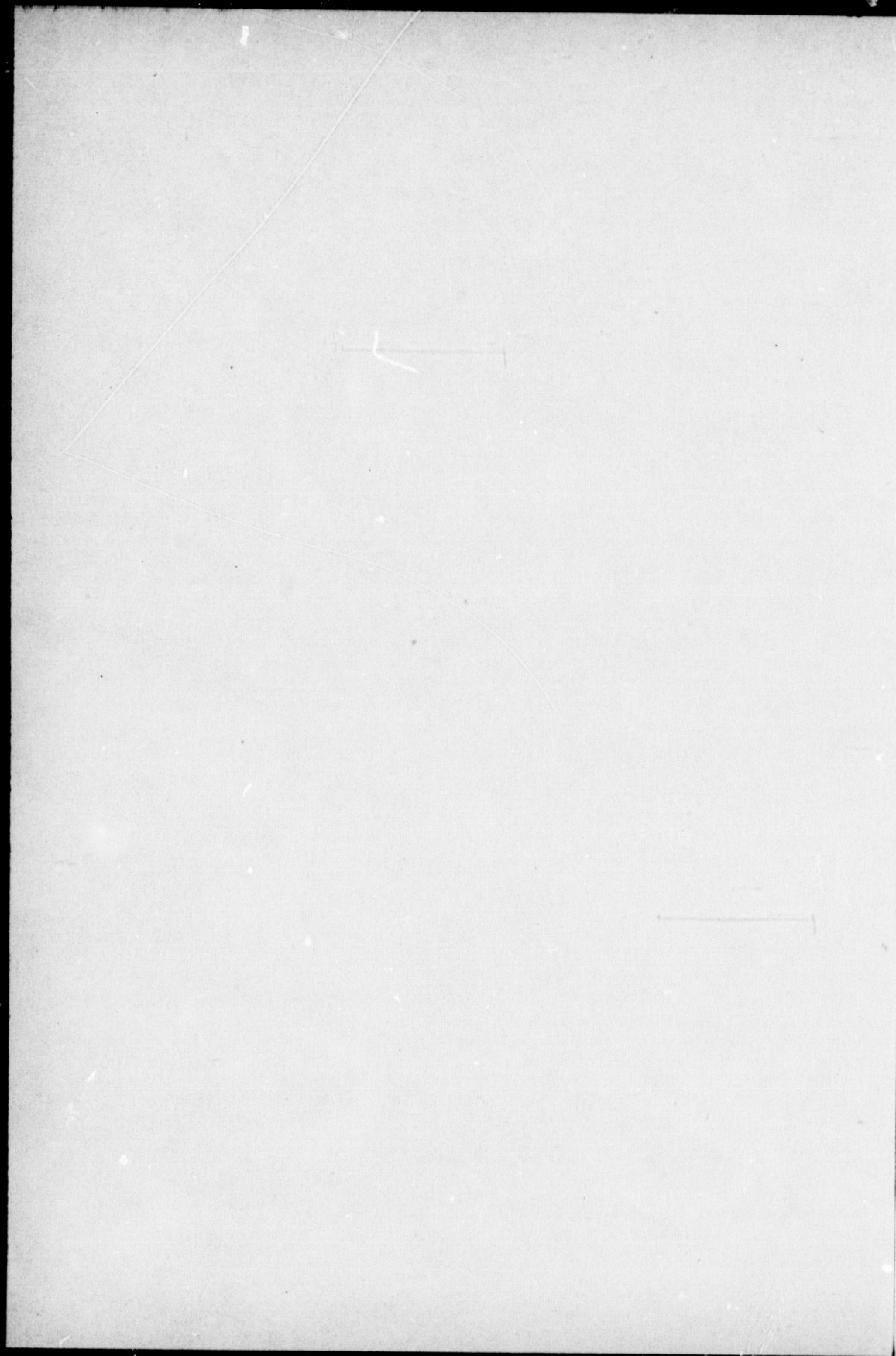


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United States Court of Appeals

FOR THE SECOND CIRCUIT.

Estate of Lorraine A. McGauley, Deceased, FREDERICK A.
McGAULEY, Temporary Executor,

Petitioner-Appellant,

versus

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

ON APPEAL FROM THE UNITED STATES TAX COURT.

PETITIONER-APPELLANT'S BRIEF.

Question Presented.

This is an appeal from the decision of the United States Tax Court finding a deficiency of \$18,393.04 in the estate tax due from the Estate of Lorraine McGauley.

The question presented is whether the Executor of Lorraine's estate is entitled to a credit for 80% of the estate tax paid by Lorraine on her husband's estate, she having died within three years of her husband as provided in Section 2013 of the Code.

Statement of the Case.

This appeal is taken from the decision of Judge Simpson in the United States Tax Court (61 T.C. 59) finding a deficiency in the estate tax payable on the Estate of Lorraine McGauley. At issue is the proper estate tax credit allowable to a wife's estate for property previously taxed in the estate of her husband.

Lorraine was the widow of Frederick McGauley. He died, leaving his entire estate to Lorraine, who paid the estate tax due on his entire estate (Appendix, p. 84a). Lorraine then died, within three years of Frederick's death. Pursuant to Section 2013 of the Code, her executor claimed a credit against her estate tax for 80% of the tax which Lorraine paid on her husband's estate (Appendix, p. 49a).

The Commissioner assessed a deficiency in the amount of \$26,688.04, disallowing a portion of the credit taken by Lorraine's Executor (Appendix, p. 8a). The Commissioner determined that Lorraine was not entitled to a substantial part of the credit because she had disposed of a part of the estate property in a will settlement, and had given other property to her son (Appendix, p. 19a).

Upon a trial of the issues, the Tax Court found that the payments Lorraine made in settlement should not be included in her estate for computation of the credit. The court also found that property which Lorraine later transferred to her own son Frederick McGauley, Jr., was includable in her estate for purposes of computing the credit. A new computation under Rule 50 was made assessing a deficiency of \$18,393.04 (Appendix, p. 47a).

By Frederick's will, he gave to Lorraine all of his real and personal property, his entire estate, absolutely, outright and forever. He also named Lorraine Executrix of his will (Appendix, p. 81a). Thereafter, Frederick's four daughters by a previous marriage objected to the probate of the will. To avoid the publicity of a lengthy court action and to preserve the family's good name, Lorraine, a prominent doctor in the community, agreed to a settlement of the will contest (Appendix, p. 87a).

The record shows that Lorraine was never restricted, by court order or otherwise, in her complete control of

the property comprising her husband's estate. Under the pressures of settlement, Lorraine paid her step-daughters directly out of her husband's estate. Lorraine wished to conclude her dealings with the girls as soon as possible after an agreement had been reached. It is common practice in the State of New York for a settlement payment to take this form, since the parties are generally interested in bringing the dispute to an early conclusion.

Lorraine received the entire estate of her husband under the terms of his will. She paid the entire estate tax due on his estate. She then died within the statutory time period.

Therefore, the Executor of Lorraine's estate appeals from the decision of the Tax Court assessing a deficiency in her estate tax in the amount of \$18,393.04.

Summary of Argument.

When Frederick McGauley died, his entire estate was transferred to his wife Lorraine under the provisions of his will. Lorraine paid the entire estate tax due on Frederick's estate. She then died, within three years of Frederick's death. Lorraine's estate is therefore entitled to a credit for 80% of the taxes which she paid on Frederick's estate, pursuant to Section 2013 of the Code.

What Lorraine did with the property which was transferred to her by Frederick's will is irrelevant for purposes of computing the estate tax credit for property previously taxed. This is clear from both the express language of Section 2013 and the legislative intent as set forth in the House and Senate Committee reports. Section 2013 is designed to prevent double taxation of the same property within a brief period of time. Lorraine has paid an estate tax once on the property in question. To disallow a credit

for that tax would be to impose a second tax within three years, exactly the result which Section 2013 is designed to prevent.

The fact that Lorraine paid her step-daughters in settlement of the will contest directly out of the estate property should not control in computing the estate tax credit. The substance of the transaction was a payment *by Lorraine* to the step-daughters, of a part of the property transferred to her by Frederick's will. The substance of the transaction clearly controls over its form.

Therefore, Lorraine is entitled to an estate tax credit for the tax paid on the entire estate of her husband, without diminution in the amount of the settlement paid to her step-daughters.

POINT 1.

Frederick McGauley transferred his entire estate to his wife Lorraine under the terms of his will, thereby entitling her estate to an 80% credit for the taxes she paid thereon.

Under New York law, Frederick's entire estate passed to Lorraine under the terms of his will. Lorraine paid the estate tax due on the entire estate. Therefore, her estate is entitled to an 80% credit for the property previously taxed in Frederick's estate.

Frederick McGauley willed all his real and personal property, his entire estate, to his wife, "absolutely, outright, and forever." Under New York law, a will by definition takes effect upon the death of the testator (Estates, Powers, and Trusts Law, §1-2.18). The will itself, and not its probate, vests both real and personal property in the bene-

fiary, subject only to the debts and obligations of the testator. *Corley v. McElmeel*, 149 N. Y. 228, 43 N. E. 628 (1896); *Waxson Realty Corp. v. Rothschild*, 255 N. Y. 332, 174 N. E. 700 (1931); *Matter of Warren*, 148 App. Div. 525, 133 N. Y. Supp. 145 (Third Dept. 1911); *Milliner v. Morris*, 219 App. Div. 425, 219 N. Y. Supp. 166 (Fourth Dept. 1927); *Matter of Strassenbergh*, 136 Misc. 86, 242 N. Y. Supp. 447 (Sur. Ct., Monroe County, 1929).

In a leading New York case, a testator willed the bulk of his estate to various nephews and nieces who were residuary legatees. The testator's widow and adopted daughter filed objections to the probate of the will, and a compromise agreement was reached. The court found that the widow took by assignment from the residuary legatees, not by virtue of any transfer under the will. The court reasoned: "The compromise did not change the will. No settlement could change a word that the testator wrote. The will stands as it was written, and the most solemn instrument, executed by all the parties interested, could not convert a bequest to the nephews and nieces into a bequest to the widow." *Matter of Cook*, 187 N. Y. 253, 259, 79 N. E. 991 (1907). Therefore under applicable New York law, Frederick's estate vested in Lorraine at the instant of his death.

In determining the extent of Lorraine's interest in Frederick's estate for federal tax purposes, due consideration must be given to the applicable local law. *Fernandez v. Weiner*, 326 U. S. 340 (1945); *Estate of Frazier*, *Exrx. v. U. S.*, 322 F. 2d 221 (5th Cir. 1963); *Estate of Frazer v. Commissioner*, 162 F. 2d 167 (3d Cir. 1947); *Ianthe B. Hardenbergh*, 17 T.C. 1966, *affd.* 198 F. 2d 63 (8th Cir. 1952); *William T. Maxwell*, 17 T.C. 1589 (1952); *Estate of Jones*, 41 BTA 1279 (1941). Such consideration is especially important in the instant case, since it reveals why the transaction took the form it did.

It is well settled that, for tax purposes, form will be disregarded for substance, and the I. R. S. can recast the transaction according to the practical realities. *Commissioner v. P. G. Lake*, 356 U. S. 260 (1958); *Higgins v. Smith*, 308 U. S. 473 (1940); *Kraft Foods v. C. I. R.*, 232 F. 2d 118 (2d Cir. 1956); *Mills Estate v. C. I. R.*, 206 F. 2d 244 (2d Cir. 1953); *Goldsmith v. Sturr*, 241 F. 2d 797 (2d Cir. 1957); *Lubin v. C. I. R.*, 335 F. 2d 209 (2d Cir. 1964).

In the instant case, the substance of the transaction was a transfer of property by Lorraine as sole beneficiary under the will in order to avoid the publicity and possible embarrassment of a court proceeding. At the time the transfer was made, Lorraine was in full control of the property comprising her husband's estate, and was under no court order not to dispose of it as she saw fit.

Since under state law, the entire estate had vested in Lorraine at the time of Frederick's death, it made little difference to Lorraine whether the settlement was paid out of the property of her husband's estate or whether it was paid out of separate funds. There is no doubt that if Lorraine had paid the daughters from her own personal funds, or if she had paid them after the estate property was settled in accounts in her own name, that the transfer would have been from Lorraine to the girls. However, the mere fact that the *form* of the transfer was a payment out of the "Estate of Frederick McGauley" does not alter the reality of the transaction. As far as Lorraine was concerned, the property from the estate had indefeasibly vested in her at the time the settlement was reached, under New York law. The agreement could not change her husband's will. Lorraine made the payment out of the estate property in order to bring the dispute to an end as soon as possible. This form of payment is common in New York practice. To hold that Lorraine is not entitled to a credit for the property which she paid out to the girls is to

elevate a local method of practice into a rule of Federal tax law.

Code Section 2013 was designed to prevent double taxation of the same property within a short period of time (S. Rept. 1622, 83d Cong., 2d Sess., 1954, pp. 121-122). Lorraine paid the tax on the property transferred to her by the will. She then died within the prescribed statutory period. This is all that is required under Section 2013. The Treasury Regulations specifically state: "It is sufficient that the transfer of the property was subjected to Federal estate tax in the estate of the transferor and that the transferor died within the prescribed period of time" (Reg. Sec. 20.2013-1[a]).

What Lorraine did with the property which passed to her by Frederick's will is absolutely irrelevant for purposes of computing the estate tax credit for property previously taxed. The Regulations expressly provide that the transferred property need not be identified in the estate of the present decedent. The property, in fact, need not even be in existence at the time of decedent's death (Regs. §20.2013-1[a]). Under Section 812 (c) of the 1939 Code, it was necessary to identify the property received from the transferor in the decedent's estate, or to trace the property in the decedent's estate back to the property received from the transferor. The 1954 Code eliminated that requirement, and based the credit on the value of the property *at the time of death of the prior decedent* (H. Rept. 1337, 83d Cong., 2d Sess., 1954, pp. 89-90; S. Rept. 1622, 83d Cong., 2d Sess., 1954, pp. 121-122).

Therefore, the fact that Lorraine used a part of the property she had received under her husband's will to make payments to her stepdaughters in settlement of the will contest, and that she later transferred part of that property to her son, has no bearing on the amount of the

credit to which she is entitled under 2013. The Tax Court admitted as much in refusing to deduct from her estate, for purposes of computing the credit, the amount of the property which Lorraine transferred to her son. There is no difference between that property and the property which Lorraine gave to the daughters, for purposes of determining the credit for property previously taxed.

The decision of the Supreme Court in *Lyeth v. Hoey*, 305 U. S. 188 (1938), is therefore inapplicable to the facts of the instant case. In *Lyeth v. Hoey*, an heir of the decedent received property from the executors of a prior decedent's estate in settlement of a will contest he had initiated. The court held that the property received under the compromise was acquired by inheritance, and was therefore exempt from the income tax. The court did not construe any provision of the tax law relating to previously taxed property, which is at issue here. It is the legislative intent behind Section 2013 which must control in this case, not the decisions under an entirely different provision of the Code. Similarly, *Thompson's Estate v. Commissioner*, 123 F. 2d 816 (2d Cir. 1941), and *Estate of Gertrude Barrett*, 22 T.C. 606 (1954), construing the marital and charitable deduction provisions of the Code, are inapplicable here.

Furthermore, in none of the cases just cited was there any showing that the substance of the transaction was anything other than a transfer from the decedent. In the instant case, the executor of the estate was also the sole beneficiary under the will. The mere fact that the payment was made from the Estate of Frederick McGauley does not alter the reality of the transaction—*payment by Lorraine*, out of property which was hers by virtue of her husband's will, made from the Estate of her husband in order to draw the dispute to an early conclusion.

POINT 2.

Lorraine's estate is allowed a credit for 80% of the taxes previously paid on the estate of her husband by the express language of Section 2013.

Section 2013, subdivision (a), provides in part:

"The tax imposed by section 2001 shall be credited with all or a part of the amount of the Federal estate tax paid with respect to the transfer of property of decedent by or from a person * * * who died within 10 years before, or within 2 years after, the decedent's death."

The Regulations under this subdivision elaborate further:

"There is no requirement that the transferred property be identified in the estate of the present decedent or that the property be in existence at the time of the decedent's death. It is sufficient that the transfer of the property was subjected to Federal estate tax in the estate of the transferor and that the transferor died within the prescribed period of time" (Reg. §20.2013-1[a]).

Subdivision (d) of the section enumerates specific reductions in the amount of the credit, including a reduction if the property is encumbered in any manner, or subject to any obligation imposed *by the transferor*. Frederick McGauley, the transferor herein, imposed no encumbrance or obligation on the property he transferred to his wife by will. He gave Lorraine his entire estate, "absolutely, outright, and forever" (Appendix, p. 81a).

It is a universal principle in the interpretation of statutes that *expressio unius est exclusio alterius*, namely, that the specific mention of one thing implies the exclusion of another not specifically mentioned. *Bland v. Commissioner*,

102 F. 2d 157 (7th Cir. 1939); *Dezsofi v. Jacoby*, 178 Misc. 851, 36 N. Y. S. 2d 672 (Sup. Ct., New York County, 1942); *Appeal of Dixon*, 11 A. D. 2d 169, 138 Pa. Super. 385 (1940); *Miller v. Commonwealth*, 21 S. E. 2d 721, 180 Va. 36 (1942). Therefore, since Congress did not provide specifically that the credit be reduced by reason of a settled will contest, such a reduction may not be implied.

The entire estate vested in Lorraine at the moment of her husband's death, and she paid the entire estate tax due thereon. Lorraine then died within the statutory period. Therefore, her estate is entitled to a credit for 80% of the taxes she paid on Frederick's estate.

It is well settled that the Congressional intent in enacting a statute will control in its interpretation. *Commissioner of Internal Revenue v. Crawford's Estate*, 139 F. 2d 616 (3rd Cir. 1943); *U. S. v. National Marine Engineers Benef. Assn.*, 294 F. 2d 385 (2d Cir. 1961); *Iacone v. Cardillo*, 208 F. 2d 696 (2d Cir. 1953).

The legislative history of Section 2013 shows that the purpose of the section is to avoid double taxation of the same property within a brief period of time (H. Rept. 1337, 83d Cong., 2d Sess., 1954, pp. 89-90). The report of the Senate Finance Committee reiterates this view (S. Rept. 1622, 83d Cong., 2d Sess., 1954, pp. 121-122). The property here in question has already been taxed once, within three years of Lorraine's death. Lorraine paid that tax. To deny her estate a credit for the full amount of the tax so paid is to impose an estate tax on the same property twice within the three year period, a result clearly contrary to the express intent of the Congress in enacting Section 2013.

Furthermore, Section 2013 is remedial in nature. A remedial enactment is one which seeks to give remedy for an ill and as such it must be liberally construed in order that its purpose may be realized. *In re Wisconsin Co-op. Milk*

Pool, 119 F. 2d 999 (7th Cir. 1941); *Securities and Exchange Commission v. Starmont*, 31 F. Supp. 264 (E. D. Washington, N. D., 1940). It has also been held that tax laws are to be strictly construed against the taxing power, in favor of the taxpayer, in order that their remedial effects may be fully realized. *Helvering v. Bliss*, 293 U. S. 144 (1934); *Pleasants v. U. S.*, 22 F. Supp. 964, affd. 305 U. S. 357 (1938); *Siegel v. U. S.*, 18 F. Supp. 771, 84 Ct. Cl. 551 (1937).

In interpreting the code provision relating to charitable deductions, the court in *Helvering v. Bliss*, *supra*, held that the provision was a liberalization of the law in the taxpayer's favor, was begotten from motives of public policy and was not to be narrowly construed. 293 U. S. 144, 150-151. The legislative history of Section 2013 shows that it was also a liberalization of the rules in the taxpayer's favor, to avoid the inequitable results of the previous Code provision. So it too must be liberally construed.

In *Siegel v. U. S.*, *supra*, the court examined the provision granting a deduction for previously taxed property, a forerunner of the present Section 2013. The court concluded that the provision should be given a liberal construction, so that "the beneficent provisions of remedial laws may not be thwarted by nice technicalities obviously within the minds of the legislators." 18 F. Supp. 771, 774.

Conclusion.

It is respectfully submitted that the decision of the Tax Court finding a deficiency of \$18,393.04 in the estate tax due from the Estate of Lorraine McGauley should be reversed.

Respectfully submitted,

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ADDENDUM.*Code Sec. 2013. Credit for tax on prior transfers.*

(a) *General rule.*—The tax imposed by section 2001 shall be credited with all or a part of the amount of the Federal estate tax paid with respect to the transfer of property (including property passing as a result of the exercise or non-exercise of a power of appointment) to the decedent by or from a person (herein designated as a "transferor") who died within 10 years before, or within 2 years after, the decedent's death. If the transferor died within 2 years of the death of the decedent, the credit shall be the amount determined under subsections (b) and (c). If the transferor predeceased the decedent by more than 2 years, the credit shall be the following percentage of the amount so determined—

(1) 80 percent, if within the third or fourth years preceding the decedent's death;

(2) 60 percent, if within the fifth or sixth years preceding the decedent's death;

(3) 40 percent, if within the seventh or eighth years preceding the decedent's death; and

(4) 20 percent, if within the ninth and tenth years preceding the decedent's death.

(b) *Computation of credit.*—Subject to the limitation prescribed in subsection (c), the credit provided by this section shall be an amount which bears the same ratio to the estate tax paid (adjusted as indicated hereinafter) with respect to the estate of the transferor as the value of the property transferred bears to the taxable estate of the transferor (determined for purposes of the estate tax) decreased by any death taxes paid with respect to such estate and increased by the exemption provided for by section 2052 or section 2106(a)(3), or the corre-

sponding provisions of prior laws, in determining the taxable estate of the transferor for purposes of the estate tax. For purposes of the preceding sentence, the estate tax paid shall be the Federal estate tax paid increased by any credits allowed against such estate tax under section 2012, or corresponding provisions of prior laws, on account of gift tax, and for any credits allowed against such estate tax under this section on account of prior transfers where the transferor acquired property from a person who died within 10 years before the death of the decedent.

(c) *Limitation on credit.*—

(1) In general.—The credit provided in this section shall not exceed the amount by which—

(A) the estate tax imposed by section 2001 or section 2101 (after deducting the credits for State death taxes, gift tax, and foreign death taxes provided for in sections 2011, 2012, and 2014) computed without regard to this section, exceeds

(B) such tax computed by excluding from the decedent's gross estate the value of such property transferred and, if applicable, by making the adjustment hereinafter indicated.

If any deduction is otherwise allowable under section 2055 or section 2106(a)(2) (relating to charitable deduction) then, for the purpose of the computation indicated in subparagraph (B), the amount of such deduction shall be reduced by that part of such deduction which the value of such property transferred bears to the decedent's entire gross estate reduced by the deductions allowed under sections 2053 and 2054, or section 2106(a)(1) (relating to deduction for expenses, losses, etc.). For purposes of this section, the value of such property transferred shall be the value as provided for in subsection (d) of this section.

(2) Two or more transferors.—If the credit provided in this section relates to property received from 2 or more transferors, the limitation provided in paragraph (1) of this subsection shall be computed by aggregating the value of the property so transferred to the decedent. The aggregate limitation so determined shall be apportioned in accordance with the value of the property transferred to the decedent by such transferor.

(d) *Valuation of property transferred.*—The value of property transferred to the decedent shall be the value used for the purpose of determining the Federal estate tax liability of the estate of the transferor but—

(1) there shall be taken into account the effect of the tax imposed by section 2001 or 2101, or any estate, succession, legacy, or inheritance tax, on the net value to the decedent of such property;

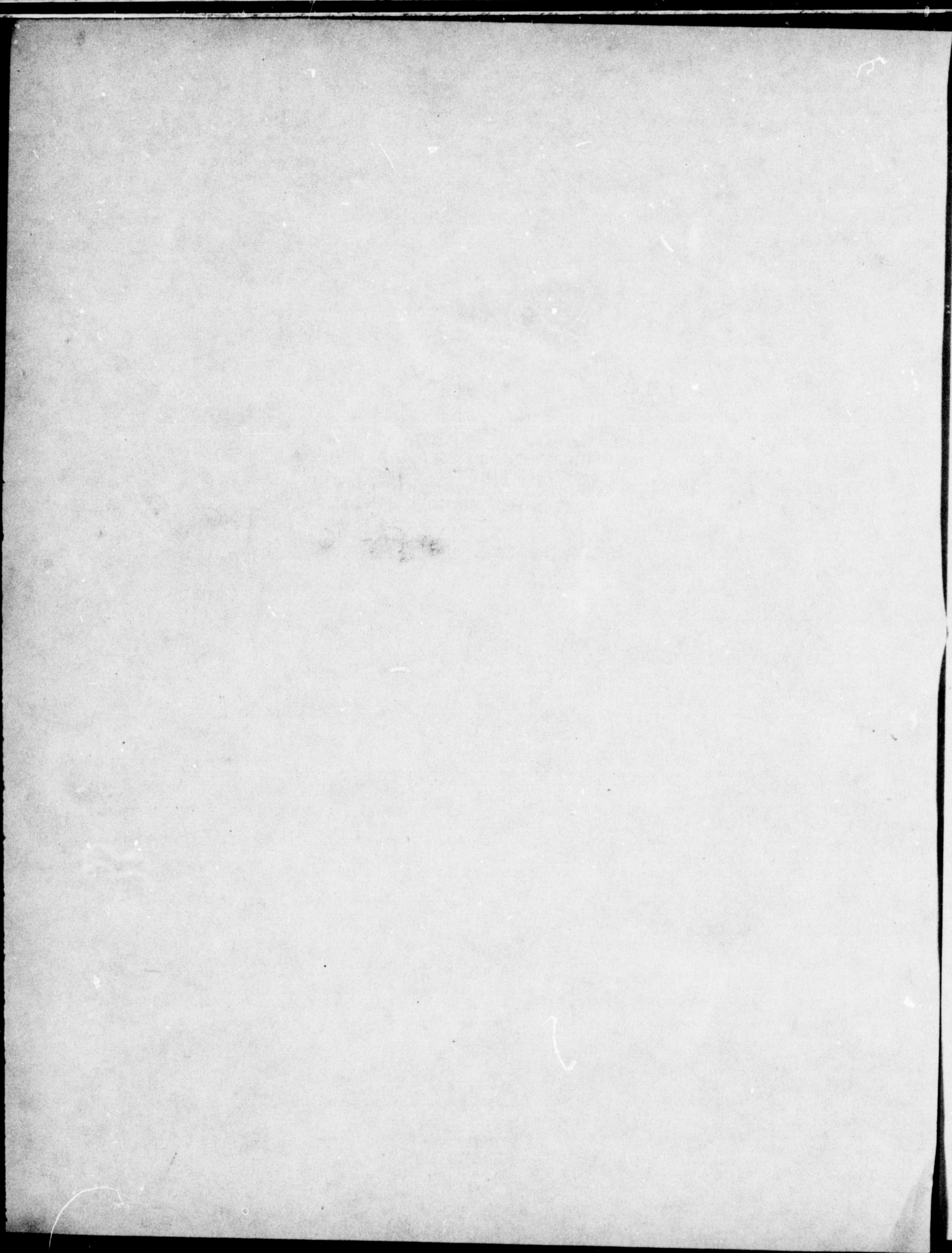
(2) where such property is encumbered in any manner, or where the decedent incurs any obligation imposed by the transferor with respect to such property, such encumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to the decedent of such property was being determined; and

(3) if the decedent was the spouse of the transferor at the time of the transferor's death, the net value of the property transferred to the decedent shall be reduced by the amount allowed under section 2056 (relating to marital deductions), or the corresponding provision of prior law, as a deduction from the gross estate of the transferor.

(e) *Property defined.*— For purposes of this section, the term "property" includes any beneficial interest in property, including a general power of appointment (as defined in section 2041).

Reg. § 20.2013-1 Credit for tax on prior transfers—

(a) *In General.* A credit is allowed under section 2013 against the Federal estate tax imposed on the present decedent's estate for Federal estate tax paid on the transfer of property to the present decedent from a transferor who died within ten years before, or within two years after, the present decedent's death. See § 20.2013-5 for definition of the terms "property" and "transfer". There is no requirement that the transferred property be identified in the estate of the present decedent or that the property be in existence at the time of the decedent's death. It is sufficient that the transfer of the property was subjected to Federal estate tax in the estate of the transferor and that the transferor died within the prescribed period of time. The executor must submit such proof as may be requested by the district director in order to establish the right of the estate to the credit.



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